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In the Supreme Court of the United States

OCTOBER TERM, 1970

SOUTHERN LOUISIANA AREA RATE CASES

MUNICIPAL DISTRIBUTOR GROUP, ET AL., PETITIONERS

v.

FEDERAL POWER COMMISSION, ET AL.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

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OPINIONS BELOW

The initial opinion of the court of appeals (Cont. App. A, pp. 1–70)[1] is reported at 428 F. 2d 407. Its opinion on petitions for rehearing (Cont. App. B, pp. 1–3) is not yet reported. The opinions (No. 546) of the Federal Power Commission (Cont. App. D, pp. 1–258) are reported at 40 F.P.C. 530. The Commission's opinion (No. 546–A) on rehearing (Cont. App. E, pp. 1–112) is reported at 41 F.P.C. 301. (Opinions 546 and 546–A are hereinafter referred to as "*Southern Louisi-*

[1] "Cont." references are to the separate appendix to the petition filed by Continental Oil Company, in No. 680.

and I"). The decision of the Hearing Examiner (III J.A. 62d–447d) is reported at 40 F.P.C. 703.

JURISDICTION

The judgment of the court of appeals (Cont. App. C) was entered on March 19, 1970, and was clarified by opinion and order on timely petitions for rehearing on June 16, 1970 (Cont. App. B, pp. 1–3). The present petitions were filed on September 9 and 14, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether a reviewing court acting pursuant to Section 19(b) of the Natural Gas Act may affirm a Commission rate order with the condition that the Commission may modify that order if it determines, on the basis of new evidence appearing since the close of the initial Commission proceedings, that the public interest requires a modification.

STATEMENT

These petitions involve the Commission's second decision regulating producer rates on an area basis. The area here is Southern Louisiana, which is defined as that portion of the state lying south of the 31st parallel, including state and federal areas in the Gulf of Mexico off the Louisiana coast (Cont. App. D, p. 6), and which covers about 54,000 square miles with similar geological characteristics, almost equally divided between land and offshore waters (Cont. App.

D, p. 10): *Southern Louisiana I* was initiated in May, 1961 (25 F.P.C. 942). The Commission issued Opinion No. 546 on September 25, 1968, and Opinion No. 546–A on rehearing on March 20, 1969.

A. Background

The Commission assumed jurisdiction over the well-head sales of natural gas sixteen years ago pursuant to this Court's opinion in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672. For approximately six years, the Commission struggled to apply the theory of public utility regulation to an industry whose risks, investments, and operations could not be compared to a pipeline, an electric utility, or any other utility with facilities dedicated to the public use. The Commission's initial effort to regulate the price for each of the nearly 2,425 producers selling in interstate commerce in 1960 on a company-by-company cost basis brought the regulatory process to a standstill. Therefore, in 1960 the Commission announced proceedings to regulate producers on an area basis. Under this methodology, an individual producer's actual costs would be immaterial in determining his rates. Instead, a ceiling price per unit of gas would be allowed uniformly to all producers in an area. While the area rate proceedings were being developed, litigation and Commission policy statements established interim ceiling prices under which permanent certificates would be granted pending the outcome of the area rate cases;

these rates were called "in-line" and "guideline" rates.[2]

For five years the Commission struggled with its first area rate proceeding, finally issuing an opinion and order in 1965 establishing area rates for the Permian Basin. *Permian Basin Area Proceeding*, 34 F.P.C. 159, 1068, 1286. The Commission's regulatory procedures there were affirmed by this Court as being constitutionally permissible and not an abuse of the Commission's powers under the Natural Gas Act. *Permian Basin Area Rate Cases*, 390 U.S. 747. Emphasizing that "area regulation of producer prices is avowedly still experimental in its terms and uncertain in its ultimate consequences" (390 U.S. at 772), this Court recognized that the *Permian* case was "the first of many steps toward a more expeditious and effective system of regulation" (390 U.S. at 772, n. 37) and called upon the Commission to "continue to examine both the premises of its regulatory methods and the consequences for the industry's future of its rate-making orders" (390 U.S. at 816, n. 99).

Only five months after this Court's *Permian* decision, the Commission handed down its initial decision in *Southern Louisiana I*—the second area rate case—which had been pending before the Commission since 1961.

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[2] See *e.g.*, *Federal Power Commission* v. *Sunray DX Oil Co.*, 391 U.S. 9; *United Gas Improvement Co.* v. *Callery Properties*, 382 U.S. 223.

B. *Southern Louisiana I and Subsequent Commission Proceedings*

In *Southern Louisiana I,* the Commission adhered to the multiple-price system adopted in *Permian* in establishing rates for the sale of natural gas to interstate pipelines (Cont. App. D, pp. 20–22). Natural gas which is not produced in association with oil production and which is being produced under contracts dated prior to January 1, 1961 was denominated "flowing gas-well gas" (Cont. App. D, p. 28). Non-associated gas produced under contracts dated subsequent to January 1, 1961 was termed "new gas-well gas" (Cont. App. D, p. 28). Generally, higher ceiling prices were permitted for the sale of new gas-well gas (Cont. App. D, p. 9). Gas produced in association with production of oil, or "casinghead gas," was given the same ceiling prices as flowing gas-well gas without regard to contract date (Cont. App. D, p. 9). The ceiling rates permitted for the sale of each were based primarily on costs (Cont. App. D, pp. 21–22).

The costs for flowing gas-well gas were developed in Southern Louisiana on an historical basis and primarily reflect expenditures for exploration and development in 1960, operating expenses in 1960, and investments which were made by producers through 1960 (Cont. App. D, pp. 85, 91, 248–49). Allocations were made by the Commission with respect to many costs and capital investments which producers incurred in the joint effort to discover and produce either oil or gas (Cont. App. D, pp. 88–93; 96–103).

A return at the rate of 12 percent was allowed on the industry-wide net book investment as of year-end 1960 (Cont. App. D, p. 104). Except for exploration and development expenditures, flowing gas costs were determined on an area basis per thousand cubic feet (Mcf) of gas produced (Cont. App. D, pp. 85, 249–50).

The cost of new gas-well gas was determined on a nationwide basis per Mcf of reserves added (Cont. App. D, p. 33). Unit costs were determined by taking the average annual expenditures for each component of cost and relating those expenditures to the average annual volume of non-associated gas reserves added or, in the case of operating expense, to the annual production volume (See Cont. App. D, pp. 31, 33). Unsuccessful exploration and development expenses, such as dry holes, were allocated between oil and gas; other allocations were also required between oil and gas (See Cont. App. D, pp. 36–37, 88–89). The applicable rate of return was applied to a rate base representing industry-wide investments spread over a 20-year recovery period and also taking into account an average lag of a year between the investment of funds in the search for gas reserves and the commencement of revenue from the sale of reserves discovered as a result of that search (Cont. App. D, p. 50). Natural gas liquids are usually found in conjunction with non-associated gas. Total finding and production costs for non-associated gas were reduced by the net market value per Mcf of such liquids (Cont. App. D, pp. 42–45). Although the Commission at the time of its 1968 decision recognized the

availability of later cost data, it did not actually employ such later data in the new gas cost calculations (Cont. App. D, pp. 36–40; 47–48). Instead, the costs were based primarily on data applicable to the period prior to 1961, although data as recent as 1966 were considered by the Commission (Cont. App. D, p. 39).

Having determined the costs involved, the Commission established three "vintages" of gas with separate ceiling prices for each (Cont. App. D, pp. 174–175). The first vintage included flowing gas-well gas and all casinghead gas; as to this the Commission fixed a maximum price of 17 cents per Mcf (Cont. App. D, pp. 175, 179).[3] New gas-well gas sold under contracts dated between January 1, 1961 and October 1, 1968 (second vintage) was given a ceiling price of 18 cents per Mcf (*Id.*). The third vintage was for new gas-well gas produced under contracts dated on or after October 1, 1968, on which an extra .5 cents would be allowed "to encourage continuation of necessary exploration and development activities and to recognize the greater uncertainties and possibilities of fluctuation [with respect to unit costs] to which the sellers are exposed" (Cont. App. D, p. 175). Accordingly, the ceiling price for third vintage gas was set at 18.5 cents (Cont. App. D, pp. 175–179).

An indefinite moratorium was also established prohibiting producers from filing for rate increases above the rates set "until such time as they may be changed by the Commission" (Cont. App. D, pp. 169–73).

[3] As to each vintage, 1.5 cents per Mcf would be added to the ceiling price of gas subject to the Louisiana production tax.

Any amounts collected above the applicable area rates established in *Southern Louisiana I* after its effective date of October 1, 1968 were to be subject to refund. In addition, with respect to rates which had been collected prior to that date subject to refund under Section 4(e) of the Natural Gas Act, the applicable area rates were to be effective from the date such Section 4(e) rates were collected, with the difference to be refunded. No refunds were required, however, to the extent that the applicable area rates were below rates allowed by a final, unconditioned permanent certificate or a settlement. The amounts of the refunds and their disposition were made subject to further Commission order. (Cont. App. D, pp. 183–88; Cont. App. E, pp. 43–46.)

On March 20, 1969, some six months after its initial decision, the Commission modified its opinion by the issuance on rehearing of Opinion No. 546–A. The moratorium for the third vintage taxed gas was given a termination date of January 1, 1974 (Cont. App. E, pp. 7–8). Moreover, because of the Commission's concurrent decision to institute a new proceeding applicable to the offshore federal domain area, Docket No. AR69–1 (hereinafter "*Southern Louisiana II*"), the Commission determined to permit rate increase filings, subject to suspension and refund, up to 20 cents per Mcf for third vintage gas-well gas in the offshore federal domain (Cal. App. B, pp. 1–8).[4]

[4] "Cal." references are to the separate appendix to the petition filed by The California Company in No. 682.

During the pendency of the instant case before the Fifth Circuit, the Commission on December 15, 1969 expanded *Southern Louisiana II* to include all vintages of gas in Southern Louisiana, both on and offshore, and called upon the parties to provide evidence on "the adequacy of gas supply and adequacy of service to consumers, the demand for gas, the cause of a gas shortage, if any, the effect of price on gas supply and demand, and other relevant economic evidence, together with the current, nationwide cost of finding and producing non-associated gas" (Cal. App. B, pp. 9–15).

On July 17, 1970, the Commission initiated Docket No. R–389A in order to determine, nationwide, "the terms and conditions which will result in an adequate supply of natural gas for consumers at the lowest rate consistent with maintaining an industry structure capable of providing, and motivated to provide, service with its attendant risks." That proceeding encompasses Southern Louisiana but only as to gas produced under contracts dated subsequent to June 17, 1970. 35 Fed. Reg. 11638.

On July 30, 1970, the Commission initiated Docket No. R–394 in order to determine whether to lift the moratorium prohibiting rate increases in Southern Louisiana that had been imposed by *Southern Louisiana I* (Cal. App. B, pp. 39–43). That proceeding remains pending.

The rates set by the Commission in *Southern Louisiana I* have never been ordered into effect.

C. The Court of Appeals Decisions

Petitions to review the Commission's orders in *Southern Louisiana I* were filed in various courts of appeals by producers, pipeline companies, distributors and one state commission and were consolidated in the United States Court of Appeals for the Fifth Circuit. On March 19, 1970, the Fifth Circuit entered its first opinion. After recognizing that the purposes of the Natural Gas Act encompassed maintenance of adequate service for the consumer, the court pointed out that the Commission had declined to estimate either the overall demand for gas or the future supply which its order would elicit, and expressed concern that this was a violation of this Court's directive in *Permian* (Cont. App. A, pp. 46–50). The court nonetheless affirmed the Commission, noting that the Commission had initiated a new proceeding—*Southern Louisiana II*—to consider the possible inadequacy of its orders and was now aware of new information on the supply situation; the court stated that an evaluation of the supply situation and determination of the action needed were for the Commission and not a reviewing court, and that the Commission's orders were procedurally and substantively adequate in light of this Court's decision in *Permian* and the fact that the "experiment" doctrine of *Permian*—giving the Commission substantial leeway to develop procedures for establishing area rates—was still in effect (Cont. App. A, pp. 56–59). Accordingly, the orders of the Commission were "sustained in full" (Cont. App. A, p. 69).

The court did, however, specifically identify improvements it felt the Commission should make in its handling of area rate proceedings. The Commission was called upon, for example, to identify and explain the rate components, to assess the character and number of individual producers that will remain after a rate order has had its effect, to assess the capital actually available to the industry as a whole and to assess the industry's probable conduct and performance as a result of an order. The court further called upon the Commission to make findings as to the market variables of supply and demand, and to set out the supply levels which its orders should elicit (Cont. App. A, pp. 61–68).

In view of these suggested improvements and in view of the Commission's knowledge of the impending natural gas supply crisis, the court acknowledged that the Commission might wish immediately to modify its *Southern Louisiana I* order despite the affirmance (Cont. App. A, p. 59) and cautioned that the affirmance should not be construed to interfere with such modification (Cont. App. A, p. 69).

Certain parties petitioned for rehearing, urging the court to remand the case for the taking of further evidence and to require further findings on the supply issue; they argued that the affirmance would preclude the Commission from modifying the rates for gas already delivered if necessary to deal with the supply problem. To assist in its consideration of those petitions, the court directed two specific questions to the Commission concerning (1) the Commission's au-

thority to stay, modify or rescind an order once that order had been "affirmed" and (2) a reviewing court's equitable powers to "affirm" while preserving Commission authority to "stay, modify or rescind" an order.

In response (Cal. App. B, pp. 51–54) the Commission stated: (1) that it would not have the authority to permit retroactive rate changes after affirmance, unless authorized to do so by the court at the time of the affirmance; and (2) that a reviewing court under Section 19(b) of the Natural Gas Act had

> * * * full statutory power to authorize or to instruct the Commission to (a) reconsider the record before it under standards set by the Court or (b) reopen the record for a specific purpose or purposes and to submit any modifications of the rate order to the same Court for further review in the light of the Court's standards, or both, without necessarily reversing the Commission and vacating the order for a new hearing.
>
> Any equitable powers which would transcend these statutory powers would be determined by this Honorable Court. (Cal. App. B, p. 53).

The Commission's response further requested the court of appeals to clarify whether it "intended to authorize this Commission to make retrospective adjustments, if it deemed appropriate, in the rates set in [*Southern Louisiana I*] *as of the effective date of the Commission* opinions (October, 1968) to the present or whether the court intended, by the use of the words 'sustained in full' * * * to restrict the

Commission to prospective changes from some future date when subsequent Commission orders, if any, are issued lifting the moratoria or establishing a new just and reasonable rate" (Cal. App. B, pp. 53–54). In addition, the Commission requested a remand of the case so that "the Commission can discharge its regulatory responsibilities consistent with the Court's opinion" (Cal. App. B, p. 54). Two of the five members of the Commission did not concur in the request for a remand, one of them stating that a remand "would create a climate which will inhibit a possible settlement in the pending [*Southern Louisiana II*] proceeding which was an outgrowth of the Commission's awareness that the gas supply situation was changing" (Cal. App. B, p. 55).

On June 16, 1970, the Fifth Circuit issued a *per curiam* order expressing its intention, pursuant to its equitable powers, to authorize the Commission to reopen all aspects of its order, including those affecting revenues from gas already delivered. Although emphasizing that its judgment was an affirmance and not a remand, the court left for the Commission's consideration what parts of the orders, if any, should be reopened in light of new evidence and stated that the Commission should have the power and the duty to review and revise its refund orders if this was in the public interest. (Cont. App. B, pp. 1–3).

Following the opinions of the court of appeals, the Commission further stayed any rate reduction pursuant to *Southern Louisiana I* until further order of the Commission (Cal. App. B, p. 31).

ARGUMENT

A.

The issues presented in the various petitions arise in the context of a potential crisis in the adequacy of supplies of natural gas for millions of consumers. Before turning to the specific issues raised by petitioners, it is necessary to understand the seriousness of the crisis and its interrelation with the area rates established by the Commission in *Southern Louisiana I*.

The Commission's staff projects on the basis of current trends, and subject to rebuttal, that by 1973 sufficient gas will not be produced to meet this country's demands unless new reserves are found at an accelerated pace. Although gas produced in Southern Louisiana accounts for approximately one-third of the total volume of gas currently being supplied across the nation,[5] directly affecting consumers in 28 central and eastern states (Cont. App. D, p. 12), Southern Louisiana has accounted for about 63 percent of the nation's total net increase in production since 1964. Production from that area, however, cannot continue to be increased at historical rates under present levels of reserve additions. Thus to a significant extent, it appears that the capacity to meet projected national demands for natural gas is dependent upon increased efforts to discover new reserves in Southern Louisiana (*Southern Louisiana II*, transcript pp. 1092–1121; 3938–4169). Accordingly, the Commission must estab-

[5] According to data filed with the Commission by interstate pipelines, the area accounted for 40 percent of the gas sold in the interstate market in 1969.

lish rate levels which provide the necessary capital and incentive to expand the exploration and development of additional reserves in this area.

Evidence concerning the present and future gas supply situation, which was ordered by the Commission on December 15, 1969 (*supra,* pp. 8–9), has been received by the Examiner in *Southern Louisiana II,* has been subjected to rebuttal and cross-examination and will be placed before the Commission within the near future. Since this evidence was not available except through allegation when the Commission decided *Southern Louisiana I,* the rates established by the Commission in that case, which have not yet become effective, necessarily were not based upon a consideration of such evidence. The refunding of approximately $375,000,000 by producers without adequate regard for (1) the effect the rates would have on the adequacy of supply to meet consumer needs, (2) the effect the refunds would have on the ability of producers to provide the capital for exploration and development programs, and (3) the effect on the number of competitors in the search for natural gas, would not be in the public interest. It must be determined whether all or part of the capital represented by the refund dollars is required for exploration and development before any refund levels are finally determined and ordered. If the Commission were limited to prospective changes of rates in Southern Louisiana, there would be no assurance that immediate capital needs, to the extent they are found to exist, could be fulfilled, since rates for future sales can generate capital only gradually over a period of years.

B.

While it is thus of great practical importance to the public that the Commission be authorized to conduct further proceedings in *Southern Louisiana I*, the legal issue raised by the distributor petitions (Nos. 669 and 691) and the petition of the New York Public Service Commission (No. 692) as to whether the court of appeals acted within its power in authorizing the Commission to conduct such further proceedings is not difficult to resolve. As an analysis of the unanimous decision below and Section 19(b) of the Natural Gas Act demonstrates, the court clearly acted within its powers and there is accordingly no occasion for plenary review of the issue by this Court. The remaining issues presented by the above and other petitions are not substantial and are premature.

1. It is misleading to contend, as do the distributors and the New York Public Service Commission, that the Commission has been granted the power to change rates retroactively. The Commission, of course, has no power to change finally approved rates retroactively and claims none. But where a reviewing court acting pursuant to Section 19(b) of the Natural Gas Act authorizes the Commission to conduct further proceedings with respect to certain rates, those rates are not final and may be revised by the Commission.

The court of appeals, in its initial opinion of March 19, 1970, criticized the Commission for failing, in setting rates for Southern Louisiana, to give adequate consideration to the future natural gas needs of the public. Recognizing that the Commission was undertaking a comprehensive review of the adequacy

of future gas supplies in *Southern Louisiana II*, during which review the Commission might discover that the rates set in *Southern Louisiana I* were inadequate, the court affirmed. The affirmance was qualified, however, and the court cautioned that the opinion should not be interpreted "to interfere with Commission action that would change the rates we have approved here" (Cont. App. A, p. 69). Whatever lack of clarity this qualified affirmance might have had was cured by the court's June 16 opinion on rehearing. The court there expressly relied on its equitable powers and its broad remedial powers under Section 19(b) to authorize the Commission to reopen any part of its orders in *Southern Louisiana I* (Cont. App. B, p. 2), subject, of course, to further judicial review.

In our view, the court acted within the scope of the authority granted to it under Section 19(b) of the Natural Gas Act. That section permits a reviewing court "to affirm, modify or set aside [an] order in whole or in part" and to "order * * * additional evidence to be taken before the Commission." That this provision contains a broad grant of equitable powers has been recognized. *Natural Gas Pipeline Company* v. *Federal Power Commission*, 128 F. 2d 481 (C.A. 7); see also *Ford Motor Co.* v. *National Labor Relations Board*, 305 U.S. 364, 374; *Dolcin Corp.* v. *Federal Trade Commission*, 219 F. 2d 742 (C.A.D.C.), certiorari denied, 348 U.S. 981.

2. The remaining issues raised by the petitions are concerned with specific elements of the methodology adopted by the Commission for the determination of just and reasonable rates for Southern Louisiana. While the court of appeals was critical of certain aspects of the Commission's methodology, it recognized that the regulatory "experiment" referred to by this Court in *Permian* was still in progress and that the Commission should be given latitude to develop and improve criteria for determining rates (Cont. App. A, p. 56–59). The court of appeals was clearly correct in upholding the Commission on these issues and no matters warranting review by this Court are thus presented.

Finally, consideration of these issues by the Court at this time would be premature and would delay the holding of further proceedings before the Commission.[6] Upon completion of those proceedings, any remaining regulatory issues could be presented to the courts.

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[6] Uncertainty caused by the petitions for writs of certiorari may well inhibit the Commission from expediting its regulatory process in this and related cases to establish stability in rate levels in Southern Louisiana. Only after stable rates are established, at levels which take into account the potential demand for natural gas and the need to discover sources of supply to meet the demand, will the public be protected against the possibility of a critical natural gas shortage. Under present circumstances, there is no assurance that sufficient capital will be available for immediate exploration needs. The Department of the Interior, for example, has given notice that offshore federal lands off Western Louisiana may be made available for lease in the immediate future. 35 Fed. Reg. 8699. Large commitments cannot be expected in the face of uncertain rate levels and uncertain cash refund requirements. Data available to the Commission indicate that these leaseholds are likely to contain large reserves of natural gas.

CONCLUSION

For the foregoing reasons, the petitions for writs of certiorari should be denied.

Respectfully submitted.

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